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INDUSTRIAL POOLING AGREEMENTS.

POOLING agreements are occasionally brought to light by the courts; but a large number live and die in obscurity, without interference, and without attracting attention from the general public. This form of combination has been strengthened and extended simultaneously with the growth in size of our manufacturing companies. The present industrial combinations, which succeeded the downfall of the trust organizations condemned by the courts more than a decade ago, have not obviated the necessity for these pooling agreements. As a matter of fact, they seem at the present time rather to have stimulated a revival; for a considerable number of combinations are now parties to the very form of agreement which they were expected to supersede. For this reason, as an important factor in the determination of prices, especially at this present time of low ebb in the fortunes of the combinations formed in 1899-1900, the character and power of these agreements deserve study.

Certain features are common to nearly all forms of pooling. Manufacturers desiring to form a pool usually create an unincorporated organization, such as the Bessemer Steel Association, the Merchants' Ore Association, or the Steel Rail Association. All agree to maintain a schedule of prices fixed by the association, and to limit their production accordingly. Each manufacturer is allowed to produce (or sell) only a certain percentage of the whole output, depending upon the capacity and advantages of his plant. To prevent violation of the agreement, a money deposit is often required from each, forfeitable to the association. In many of the more intricate cases, the agreement is drawn up by counsel in New York, Pittsburg, or Chicago, the lawyers' offices being used as headquarters for the association. The duties of the legal

firm often include, at the same time, the auditing and verification of reports from the various companies. To do this work, a large force of expert accountants may be employed. A fine is imposed where these reports show a production greater than the allotted percentage, and a corresponding bonus is given to plants producing less than their allotment.

The regular meetings of the representatives of the constituent companies are held usually in November or December, in order to adjust prices and allotments for the ensuing year. On account of the non-enforceability of the agreement the minority must be treated fairly. Their withdrawal would mean the breaking up of the association. The money deposit restrains the members from withdrawal only when under slight provocation. The affairs of the pool are handled by the united action of the ablest men in the business. Each owner can manage and develop his own plant, with every inducement to reduce expenses. He knows very closely the amount of his annual output, so that the most economical production would seem possible under such an arrangement.

Territorial division of the market was a feature of the railroad pools, but has not been adopted by many industrial associations. This end is sometimes loosely accomplished by making all factory prices uniform, and adding the freight from factory to selling place to obtain the price at that point. Thus, in the iron and steel associations, prices are usually figured from a base price at Pittsburgh. The amount of the freight from this base to the selling point must be added to the base price, to obtain the selling price. For example, if the Pittsburgh base price of steel plates is \$1.40 per hundred pounds, and the freight from Pittsburgh to Iowa is 35 cents, the price in Iowa is \$1.75, whether a Chicago or a Philadelphia concern does the selling. This operates to prevent waste in transportation by keeping shipments moving in directions away from the base point. Shipments made toward it suffer a loss in selling value as well as by reason of the expense

for freight. Only very strong local interest can secure such a schedule, increasing still further the strength of its position.

Several pools have omitted the feature of percentage allotment, and have placed a tax upon all manufacturing. These are familiar, as they have come before the courts. In the case of the Candle Manufacturers' Association,¹ formed in Ohio in 1880, the members were required to pay into the treasury 2½ cents for every pound of candles sold. A more modern pool, the Addystone Pipe and Steel Company, had an elaborate system by which it fixed the price that a city should pay for pipe, and then gave the contract to the member offering to pay to the pool the highest amount for it. The others put in bids to cover appearances, but took care to name a higher price than that agreed upon. Certain companies were permitted to take all the contracts let by large cities near them, called "reserve" cities. In 1899 the Sherman Act was successfully invoked to terminate this arrangement.²

An entirely different form of avoiding competition is through the adoption of a joint sales agent. The various firms agree to sell only through a certain agent or selling corporation. This agent contracts with each firm separately, but guarantees a uniform selling price. He also disposes of the goods from different firms in a given ratio. This ratio may be fixed or may vary with agreed conditions. An exported article would be advantageously controlled in this way. An arrangement of the same sort is most common in the case of articles not patented, and of long established use and approximately standard design. The Union Blue Stone Company³ in this way effected all the sales for the Blue Stone Association, fixing the price to be charged and the quota to be furnished by each member.

Still another form of pool is based upon patents essential to the manufacture of the article. The patentee sells

¹ 47 Ohio State, 320.

² 20 U. S. 97.

³ 164 N. Y. 401.

the rights of use, for a uniform royalty, to all who apply. He also limits the quota to be produced by each firm, above which amount the royalty increases rapidly. Various ways by which patents may be used to control production have been adopted. Thus, for example, the United States Consolidated Seedless Raisin Company was an association of nine California firms, owning all the patented raisin-seeding machinery. Members of the company paid a royalty of $\frac{1}{8}$ cent per pound, but outside firms were to pay $\frac{1}{2}$ cent. This form of agreement the courts have upheld as legal.¹ In another case—that of the National Harrow Company—the manufacturers agreed to pay to the owner of the patents, \$1 royalty on each harrow sold, and \$4 additional on every harrow sold for less than a stipulated price. This form of agreement, unlike the preceding one, was held to be unenforceable at law.²

It is common knowledge that pooling agreements of one sort or another are numerous at the present time, but the secrecy with which they are guarded makes it difficult to discover their real extent and character. A single New York law firm, a few months ago, making a specialty of these associations, superintended no less than thirty-nine, each covering some manufactured product in the metal trades. But pools are not restricted to the iron and steel business. They cover a wide range of industry. A part of Mr. C. M. Schwab's testimony before the Industrial Commission bears upon this point.³

In the iron and steel trade, however, there would seem to be the majority of these pooling associations and price agreements in operation. As soon as the ore is dug, it is

¹ 126 Fed. Rep. 364.

² 76 Fed. Rep. 667.

³ *Industrial Commission Report*, vol. xiii. p. 474: "The steel rail pools were simple price agreements between the managers of the various works, to sell rails at the same price at the same point.

"Q. For manufacturers before the organization of the United States Steel Corporation were similar arrangements existing?

"A. Yes: in all lines of business, not only in steel, but in everything else. There were similar agreements, known as joint agreements, to maintain prices. They have existed in all lines of business as long as I can remember."

regulated by an association. The "independent" ore producers have organized the Merchants' Ore Association of Cleveland, which adjusts their relations with each other and with other ore producers, such as the United States Steel Corporation. The association attempts to establish the price of the various grades of iron ore and to state to each "independent" the maximum amount of ore that it may produce. The price must be satisfactory to the Steel Corporation. The Merchants' Ore Association naturally desires low prices to enable it to sell the largest possible amount of product. With the steel makers owning ore deposits, the price is largely a matter of book-keeping; but the endeavor is, nevertheless, to keep it high, in order to raise the cost of production for rival steel mills not owning mines. The price of Bessemer ore for 1903 was \$4.50 per ton.¹ For 1904 the association wished it to be between \$3.25 and \$3.80, while the Steel Corporation demanded that \$4 be the price, threatening to sell ore itself. The Ore Association was, however, allowed to fix it at \$3.50, although several of its members made long-term contracts to deliver at a sliding scale price, fluctuating with the price of pig iron. This made it impossible for the association to adjust the allotments satisfactorily, and its continued existence was threatened.²

Concerning the next stage of manufacture above mining,—namely, of pig iron,—there are also price agreements among the furnace men, who have formed the Bessemer Pig Iron Association. A pool based on steel ingot production was attempted unsuccessfully. Steel billets, however, we find pooled in 1896, and again since 1900. The heavier materials—steel rails, beams, channels, angles, bars, plates of all kinds, shafting axles and rods, wire and wire fencing—are likewise all priced by pools. Among the lighter forms covered by such agreements are chains, nuts, bolts, steel hoops, and bands, pipes and tubing, and hardware. A prominent retail hardware firm stated to

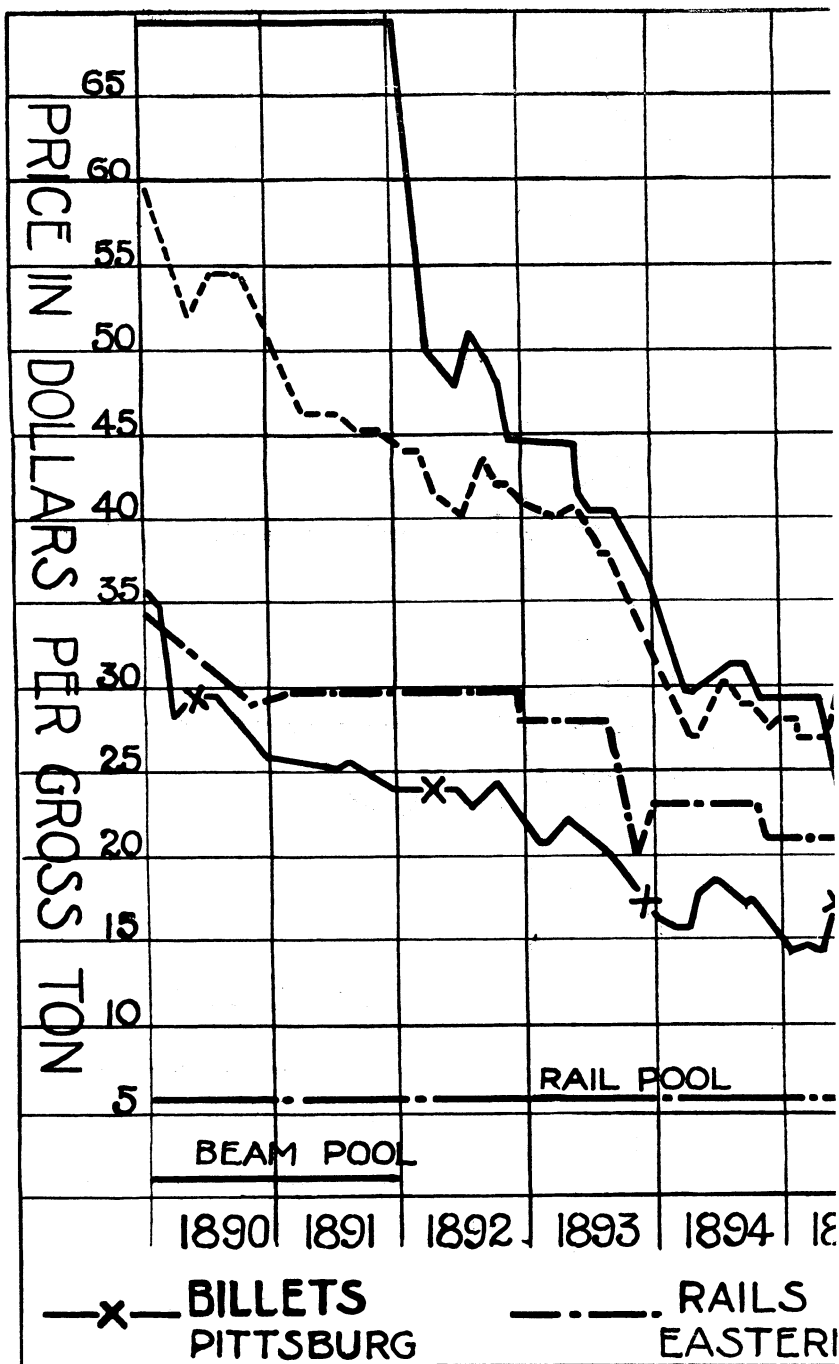
¹ *New York Journal of Commerce*, April 22, 1904.

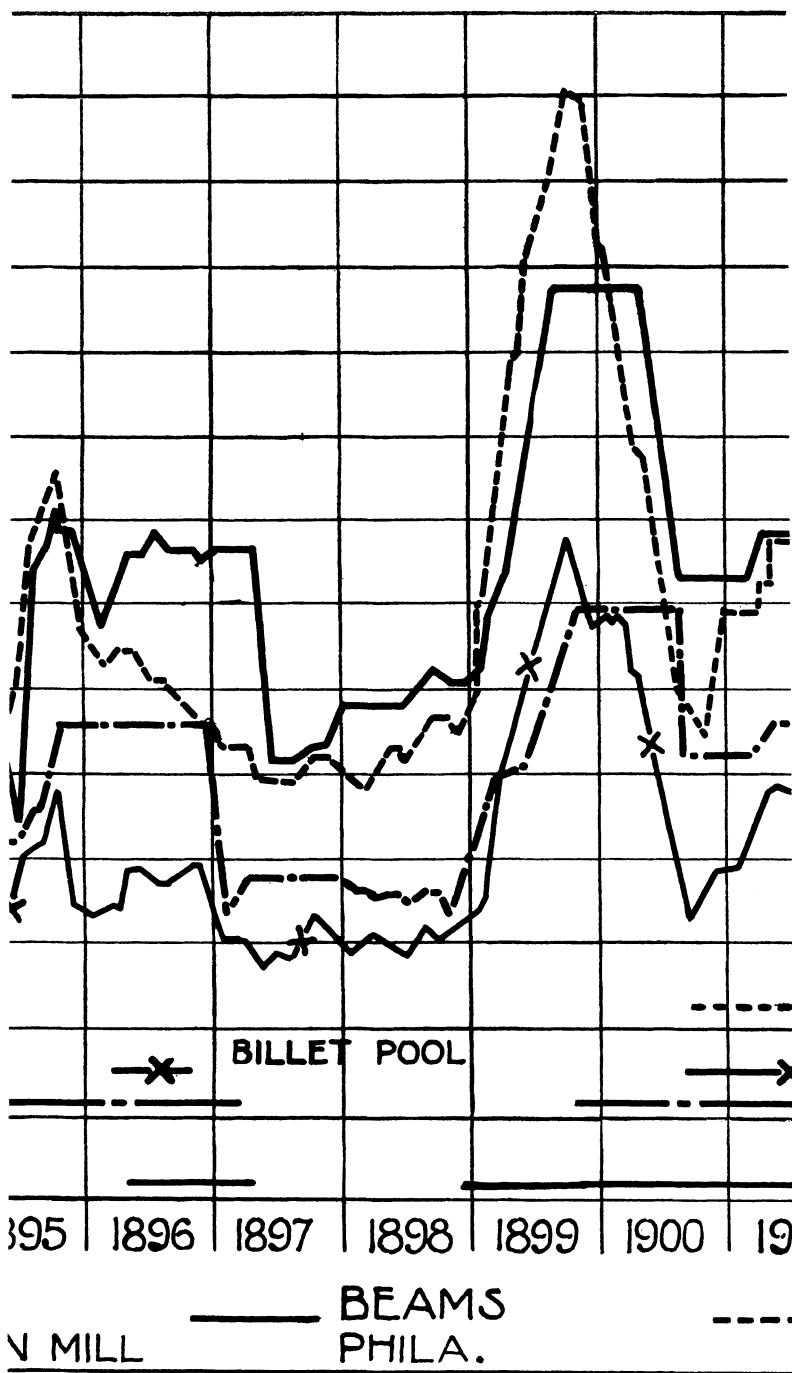
² *Iron Age*, May 5, 1904.

the writer that the hardware manufacturers had agreements as to prices covering practically everything in the store, "all shelf hardware" in fact. Judging from the iron business, we may expect to find pooling agreements developed up to the point where trade-marks, style, or individual reputation, become predominant considerations in making a market for the goods.

Four of the most important steel products—billets, rails, beams, and plates—have been specially selected in this study for more detailed analysis as to the effect of pooling upon prices. The appended diagram has been prepared to show the range of prices since 1890. Only a very brief review of the pools that existed during these years can be given. Were a detailed history of their operations available, the problem presented by their existence might be dealt with more intelligently.

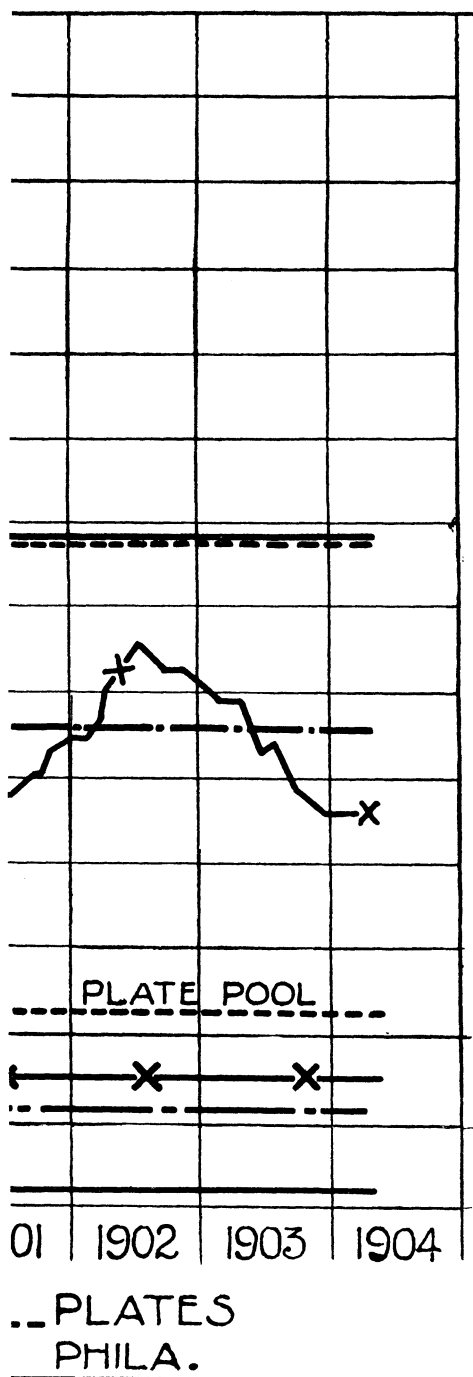
The first billet pool was formed in April, 1896, as an attempt to remedy the extreme fluctuations in price of the year 1895. The Bessemer Steel Association, as it was called, allowed to each firm a percentage of the billet business of the country, estimated at 4,500,000 tons, and imposed a fine of \$2 per ton for any excess produced. The association immediately fixed the selling price considerably higher than demand justified, at \$21.50. Outside firms promptly took orders at \$19.50; and there was also much selling contrary to the agreement by insiders, thereby weakening the pool from the beginning. Moreover, it was possible for the larger firms to avoid the fines for overproduction by converting the steel billets into finished shapes before selling. The pool was so very ineffective that a reorganization followed; but even then the agreement could not maintain prices against a demand refusing to accede to the high figure. As the agreement applied only to Bessemer steel, the open hearth steel production was greatly stimulated. An additional open hearth capacity of 500,000 tons and a score of new outside converters helped break up the pool. The guarantee fund of \$5,000 failed





PRICE CHART FOR ROLLED STEEL

SEE IRON AGE JANUARY 1898 TO 1902



to prevent its collapse in December, prices falling to \$15. The pool had sacrificed what business there was, and had brought out an array of new competitors.¹

In 1899 the price of billets rose wildly from \$16 to \$38 per ton, and in 1900 fell no less abruptly to \$16. The billet makers decided that they must attempt another agreement.² A base price of \$19.40 was established, which was easily held, as prices began to rise. But the sliding scale device for fixing the price of billets became an important factor in 1901, the price being found by adding the cost of conversion to the price of pig iron. For instance, if the price of pig iron lies between \$16 and \$17 per ton, the price of billets is found by adding \$6.50. The larger manufacturers adopted this scale, and the subsequent existence of the billet pool has been nominal. Price agreements have been made, and hold or fail as the demand varies. The nominal price of \$28, agreed upon by the pool in July 1903, was reduced to \$24 in November, and then to \$23.³ The descending lines of the price curve since 1902 show that the pool has not been able to name the market price. It seems to be shown that the outside billet supply is always very elastic, rendering the billet manufacture essentially competitive.

The rail pool shows remarkable strength, having named prices for sixteen years, with the exception of 1897 and 1898. This pool was formed in August, 1887.⁴ It divided the estimated rail demand among the fifteen members, in agreed proportions. The fixing of prices was not part of the written contract, but informal agreements were entered into. A penalty of \$1.50 to \$2.50 per ton

¹ *The Iron Age*, 1896, vol. i. p. 875, gives the original price agreement adopted; vol. ii. p. 223 gives the difficulties encountered; vol. ii. p. 967 describes the billet market, names the leading producers, and the chances of the pool.

² *Ibid.*, January 3, 1901, gives a summary of the billet business of 1900, and conditions leading to the pool of November 8, 1900.

³ *The Journal of Commerce*, April 8, 1904, reports a meeting of the pool, naming the members. The present agreement includes the United States Steel Corporation, Jones & Laughlin's, Wheeling Steel and Iron Company, Cambria Steel Company, Lackawanna Steel Company, Pennsylvania Steel Company, and Maryland Steel Company.

⁴ *The Iron Age* of November 16, 1893, gives full details.

for all excess of allotment kept the firms from cutting prices in order to secure more business. In regard to prices during the existence of this combination the *Iron Age* remarks: "The price that was asked for rails by the mills was decidedly reasonable. Manufacturers whose demand varies ought not to starve the mills in poor times." The agreement came to an end in 1893, but was renewed after a sharp fight. Increasing difficulty was met in adjusting the allotments during the following years. Outside concerns had to be bought off or subsidized until, in 1896, \$1,000,000 was spent in this way. It had been estimated that the demand for that year would be about 2,200,000 tons, but it was actually only 800,000 tons. Concerns that had produced little, and expected heavy bonuses, found that they had to pay a penalty. The dissatisfaction resulted in secret cutting of prices and the breaking up of the pool.¹ There was immediate talk of renewal; but it was not attempted until prices began to rise in 1899, when the present pool was formed.²

The contrast between the billet and the rail price curves is very striking. The former is irregular, showing constant fluctuations; while the latter is made up of long horizontal lines, with abrupt changes, showing that the effect of the pool was to steady prices for considerable periods. In justice to the rail pool it should be noted that in 1901 and 1902, when billets rose from \$20 to \$32, the price of rails remained \$28. The price of beams was also held, but the plate pool raised the price \$4. Agreements hold well in the rail business, because it is confined to less than a dozen firms, and is comparatively easy to control.³ Rails are

¹ The *Iron Age*, February 11, 1897, reviews the pool's history.

² *Ibid.*, January 1, 1901, describes the agreement made.

³ *Ibid.*, of February 11, 1897, gives the 1897 allotment thus:—

Carnegie	53.50 per cent.
Lackawanna	19.00 " "
Cambria	8.25 " "
Bethlehem	8.25 " "
Maryland	2.75 " "
Pennsylvania	8.25 " "

100.00 " "

sold direct to the consumer; and, moreover, special freight rates may have helped to keep up the market price of this product.

The beam pool was organized soon after the rail pool by the mills rolling structural steel shapes, such as I-beams and channels. The \$70 figure of 1890 was a pool price, maintained under small demand, by eleven firms producing nine-tenths of the supply. Foreign beams began to be imported in 1891 at \$46; and, to stop this, the pool agreed to lower the price to \$56. But the Carnegie Company had just finished a beam mill large enough to supply the whole demand of the country, and was not satisfied with the allotment given by the pool. This company seems to have been constantly on the alert, when pooling agreements were weakening, to gather in orders at lower figures. Prices fell \$22 at once. Boston merchants had a stock of 2,500 tons of imported beams left on their hands to dispose of at a loss, and many manufacturers suffered heavily.

An agreement made in 1896 held for a short time, but was broken in the attempt to keep prices stationary in a declining market. Even when the rail pool broke, the beam makers do not seem to have realized that it may be expedient for pools to lower prices as well as to raise them. When the break occurred, in May, 1897, the price of beams fell \$12 a ton.¹

The present pool was formed in 1898 by six leading firms.² The agreement since then has been renewed annually. The price has been kept at \$1.60 per hundred pounds, Pittsburg, since 1901. Foreign beams came in during 1902-03 on account of the overcrowding of our mills, being able to command a premium by quick delivery. The steadiness of the price of steel beams during 1901-02, as shown by the chart, when billets rose rapidly, is in marked contrast with the fluctuations of 1899,

¹ *The Iron Age* of May 20, 1897, describes this pool.

² *Ibid.*, January 12, 1902. The firms are the Carnegie Steel Company, Jones & Laughlin's, Cambria Steel Company, Pennsylvania Steel Company, Passaic Iron Works, Pencoed Iron Works.

when, as billet prices rose, the beam makers advanced prices with leaps and bounds. This change of policy was partly due to the influence of the Steel Corporation. More than any other steel company it must maintain a large volume of business without interruption in order to meet heavy charges. The price of beams in this case was already sufficient to give a reasonable profit. Moreover, a large demand indirectly increased the corporation's profits by reason of its ownership of other subsidiary companies.

The plate pool is a recent development, having existed since 1900 only. The line on the diagram, showing the course of prices of steel plates, is remarkable, inasmuch as it shows a far more violent fluctuation during 1899-1900 than in the case of the other pooled products,—rails and beams. In February, 1899, the price of plates was \$1.30 per hundred pounds at Pittsburg. Buyers who anticipated high prices bought until in August the price had reached \$3. As the turning-point was seen, buyers, becoming frightened, withdrew; and the rolling mills fought to secure business, until a price of 95 cents was reached in July, 1900. This ruinous condition was the cause of several meetings, resulting in an agreement between the plate mills in October. Orders came in as soon as the stability of the pool seemed assured, and the year closed with 400,000 tons of orders on hand. Prices were fixed as usual, with a Pittsburg base, freight being added to this base for prices at other points.

An enormous demand for steel plates developed during 1901-02, due largely to the steel car and steel ship industries. The price was raised to \$1.60 in April, 1901, at which it has now stood for three years. The growth of new rivals was checked, and the maintenance of the price during the present slackness was made easier, by the policy of reasonable prices in good times. The pool prevented buyers from competing and pushing up prices in 1901-02, although small mills at one time secured 65 cents excess, for immediate delivery. This excess disappeared in July, 1903, when mills began to close down for lack of orders. The

old price was renewed, however, in December.¹ It was thought that the small demand could not be increased by a slight reduction in price. This, however, would seem to be dangerous reasoning, judging by the failures of other pools under similar circumstances.

General conclusions are apt to be misleading on a subject such as this, where full information is carefully withheld; but from the available history of these pools, as outlined, certain facts seem to be fairly well established. It is not possible by law to prevent all price agreements, nor is such a policy desirable. For in such an event, with quick transportation at low rates, competitors are free to fight each other until the more powerful firms drive the weaker ones to the wall. The victors are then free to recoup their losses as quickly as possible at the public expense. Both very low prices and exceptionally high ones are harmful to business in general, and to the public. The manufacturers would seem to be justified in making some agreement, and in allowing one another to continue to share in the business in definite proportions, in order to prevent this destructive warfare.

Two remedial policies are open to competitors in such an event. Either an industrial combination may be effected; or refuge may be sought in one of these price agreements or pools. The railroads were driven to adopt the policy of buying up competitors,—a policy resulting, for a time at least, in embarrassments and receiverships. They have found it necessary to come to some agreement on reasonable and equal rates. The industrial companies, following them some years later, have attempted gigantic consolidations, the result of which is at present doubtful. Most manufacturers would prefer to own their own plants, making whatever arrangements were necessary for continued existence, rather than to lose their identity by selling to a corporation. And direct management by a manufacturing owner may be expected to be more

¹ *Journal of Commerce*, December 19, 1903.

efficient than management by distant financiers representing stockholders.

The second remedy for ruinous competition lies in industrial pools, such as were constantly formed, broken up, and reformed, until about 1900. This instability seems to have resulted from the fact that no pool or price agreement can continue where the price has not been fixed at a reasonable figure; for new capital is always ready to seek investment where profits are known to be ample. However widely the pool may extend, it cannot absorb all of this idle capital. Only when the pool price is too low unduly to tempt the outsider to build or enlarge his plant is its position at all secure. Another factor of note is that pools are always most favorable to the outside plants, which can enjoy the advantages of the pool price without feeling the restrictions.¹

Inherent weakness breaks up many, from dissatisfaction with the allotment and the constant temptation to shade the price or to conceal sales. The pools are in several instances being supplanted by the sliding scale adjustment of prices, based upon the price of the raw material. The effect of the temporary pools is thoroughly bad. Their false profits lead to a misdirected investment of capital, as in the case of the nail pool, where plants sprang up during high prices, so that two months' full operation would have supplied the market for a year. The inevitable price variations are greatly exaggerated, because purchasers refrain from buying when the market is falling, sending prices to the very bottom. Mr. Meade's statement, that the prices which follow the dissolution of a pool are lower than those that brought the producers together,² has been frequently illustrated.

These powerful associations exist without supervision of any kind, our knowledge of them being gained chiefly

¹See the *Industrial Commission Report*, vol. xiii. p. 492. Mr. Butler says, "I would state as a general law that combinations are always to the advantage of the small concern. . . . that a combination was always to the advantage of the little fellow, whose growth is at the expense of the large concern."

²*Trust Finance*, E. S. Meade, p. 28.

as they fail. Although, since the Trans-Missouri Joint Traffic and other anti-combination decisions, all such arrangements have been carried on in secret, it is doubtful if their scope has been appreciably diminished. During the last four years they seem to be on the increase, as a matter of fact. Having been denied recognition by law, they have necessarily devised methods of their own, to preserve their agreement by fines and bribes. Their existence and effectiveness at present would seem to indicate reasonable prices as well as reasonable use of their inherent power in other ways. Experience shows that, were their policy otherwise, the pool would be in danger of breaking suddenly at any time. In any event, a more satisfactory arrangement is certainly desirable. In Germany, pooling agreements have been made enforceable by the courts, and their affairs are subject to government supervision. The evils caused by pools with the "get-rich-quick motive" might, perhaps, in the United States be avoided by a similar legal recognition of the economic justification for associations among independent manufacturers, with agreements both reasonable and enforceable.

WALLACE E. BELCHER.